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IFRS Developments

The IASB proposes major changes to primary financial statements

What you need to know

- The objective of the Primary Financial Statements project is to remove inconsistencies in entities' reporting.
- In the ED, the Board proposes major changes to the primary financial statements, such as:
  - Additional guidance on aggregation and disaggregation of information.
  - Introduction of categories and subtotals in the statement of financial performance.
  - Requirement to provide disclosures about unusual items.
  - Requirement to provide disclosures about management performance measures.
  - Introduction of certain narrow -scope amendments to the cash flow statements.
- Comments are due by 30 June 2020.

Highlights

On 17 December 2019, the International Accounting Standards Board (the IASB or the Board) issued an Exposure Draft, *Primary Financial Statements (ED)*, in which the Board proposes to replace IAS 1 *Presentation of Financial Statements* with a new standard. In the ED, the IASB is proposing new disclosure requirements and has developed new presentation requirements for the statement of financial performance, accompanied with limited changes to the statement of financial position and the statement of cash flows. The Board is proposing to reduce the presentation choices for items in the primary financial statements to make it easier for investors to compare entities' performances and future prospects. The ED is designed to remove widespread inconsistencies in entities' reporting.

Key proposals

Under the ED, entities will be required to prepare their statement of financial performance in the manner prescribed, leading to greater comparability across entities and industries. The key proposals in the ED are summarised below:

1. Statement of financial performance

The ED introduces categories and subtotals in the statement of financial performance. Notwithstanding that some of the terms are similar to those currently used in the statement of financial performance, the new definitions in the ED may require entities to change the composition of some of the subtotals.

Building a better working world

The introduction of required and defined subtotals will result in a more standardised statement of financial performance. A summary of a statement of profit or loss is shown below:

	Revenue
−	Operating expenses
	Operating profit or loss
+	Share of profit or loss and income and expenses from integral joint ventures and associates
	Operating profit or loss and income and expenses from integral associates and joint ventures
+	Share or profit or loss of non-integral associates and joint ventures
+	Income from investments
	Profit or loss before financing and income tax
+	Interest revenue from cash and cash equivalents
−	Expenses from financing activities
−	Unwinding of discount on pension liabilities and provisions
	Profit or loss before tax

The ED proposes a format of categories in the statement of financial performance, where the operating category is the default or residual category. The categories comprise the following:

- *Operating* - The ED proposes to prescribe the use of operating profit. Currently, most entities already present an operating profit measure, but the content of operating profit measures can vary quite significantly across entities. The ED proposes that operating profit is profit from the main business activities before income and expenses from integral associates and joint ventures, and before investing and financing items.

- *Integral associates and joint ventures* - The ED proposes to require the presentation of 'integral' and 'non-integral' associates and joint ventures separately. An entity's share of the profit of integral associates and joint ventures (including impairment losses and reversals, and gains and losses on disposal of the investees) is to be presented below the operating category, but before the investing category. An entity's share of the profit or loss of non-integral associates and joint ventures will be included in the investing category.

- *Investing* - This category will be presented in the statement of financial performance as "Income/expenses from investments", below the operating profit subtotal, and includes "Income/expenses from assets that generate a return individually and largely independently of other resources held by the entity".

- *Financing* - This category will include "Income from cash, cash equivalents and financing activities" and "Expenses from financing activities", as well as income and expenses on liabilities not arising from financing activities, such as unwinding the discount on decommissioning liabilities.

How we see it

The proposed format for the statement of financial performance distinguishes between operating, investing and financing activities. The share of profit from integral associates and joint ventures falls outside these three categories, and effectively represents a separate category. In the cash flow statement, however, cash flows from both integral and non-integral associates and joint ventures are to be presented in the investing activities section. The Board clarifies in the ED that it did not attempt to align classifications across the primary financial statements.

The above categorisation is accompanied by a requirement to present four subtotals/totals, as shown in the above figure, i.e. (1) operating profit or loss, (2) operating profit or loss and income and expenses from integral associates and joint ventures; (3) profit or loss before financing and income tax; and (4) profit or loss. Although (3) appears to be the same as the commonly used EBIT (earnings before interest and tax) subtotal, the Board decided not to describe it as EBIT, since it may include interest revenue and it may exclude certain financing items that are not interest.

The Board proposes to require entities with a main business activity of providing financing to customers to classify income and expenses from financing activities and income and expenses from cash and cash equivalents in the operating category. Furthermore, an entity that classifies all expenses from financing activities in the operating category shall not present a subtotal of profit or loss before financing and income tax.

2. Location of information and disaggregation

The ED includes a principle for determining the location of financial information in the primary financial statements or the notes that is based on the role of the primary financial statements and the role of the notes, consistent with the Discussion Paper *Disclosure Initiatives – Principles of Disclosure* (March 2017).

Aggregation and disaggregation should be done with reference to similar and dissimilar characteristics, according to the ED. Information that is too aggregated may hinder a user's understanding, while too much detail may obscure material information. Items with similar characteristics should be aggregated together whilst items that are dissimilar from other items should be presented separately.

3. Analysis of operating expenses

IAS 1 requires an entity to present an analysis based on the nature or the function of the expenses in the statement of financial performance by choosing the method that is reliable and most relevant. In practice, some entities use a combination of both methods. The Board proposes to strengthen this by requiring an entity to use the single method that would provide the most useful information. Factors that may be considered in the determination of whether to present expenses by nature or function include drivers of profitability, how management reports internally and industry practice.

4. Unusual income and expenses

The ED states that unusual income or expenses are those with limited predictive value because it is reasonable to expect that similar items will not arise for several future reporting periods. Similar income or expenses are those that are similar in type and amount. The ED requires the disclosure of unusual income and expenses in the notes to the financial statements and the statement of financial performance lines to which they are attributed. Any unusual expenses should be attributed to categories of expense by nature, regardless of presentation in the statement of financial performance. Entities will also be required to provide a narrative description of the events that give rise to unusual income and expenses.

5. Management performance measures

The ED proposes that entities disclose information about any management performance measures in a single note to the financial statements. The ED lists several disclosures to be made, such as information on how the measure is calculated, how it provides useful information, and a reconciliation between the measure and the most comparable subtotal in the statement of financial performance. The identified management performance measures should be the same measures an entity uses in its other public communications. Such management performance measures should be clearly distinguished from the subtotals specifically required to be presented. The ED does not prohibit presentation of a management performance measure in the statement of financial performance, but such presentation must fit the structure of the proposed categories and not disrupt the presentation of the analysis of expenses in the operating category. Furthermore, the ED proposes to prohibit the use of a column approach to present management performance measures.

6. Statement of cash flows

The ED proposes to eliminate the current policy choice for classification of cash flows from interest and dividends in the statement of cash flows. For non-financial entities, dividends and interest paid should be classified as financing cash flows, whilst dividends and interest received should be classified as investing cash flows.

Within the cash flows from investing activities section of the statement of cash flows, the cash flows from integral associates and joint ventures should be presented separately from non-integral associates and joint ventures based on the same classification as was applied in the statement of financial performance.

When applying the indirect approach, the ED clarifies that the starting point for the reconciliation is the operating profit subtotal.

Financial entities shall classify cash flows from dividends received, interest paid and interest received as separate lines in a single section of the statement of cash flows. If the entity presents income or expenses in a single section of the statement of financial performance, the entity shall present the related cash flows in that section of the statement of cash flows. If the entity presents related income in more than one section of the statement of financial performance, then it shall make an accounting policy choice as to where to present these items in the statement of cash flows. Dividends paid should be presented in the financing section of the statement of cash flows.

Next Steps

The comment period for the ED ends on 30 June 2020.

How we see it

We encourage stakeholders to provide feedback to the IASB in the form of comment letters, to contribute to a well-grounded and robust discussion when the Board considers making final amendments to the requirements in the next phase. Given the pervasiveness of the topic, the ED deserves the attention of all relevant stakeholders, including preparers, users, auditors and regulators.

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ED None